

**FINANCIAL MANAGEMENT IN  
HUNGARIAN LOCAL  
GOVERNMENTS:**

**THE CASE OF SZOLNOK**

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## EXECUTIVE SUMMARY

### ***Background Information***

Regional conditions and economic processes:

- Situated on the border of two regions
- Artificially created central role
- The collapse of former large industries
- Highly qualified labor
- Obsolete and incomplete infrastructure

Regional cooperation:

- Regional association
- Statistical sub-regional association
- The association of cities with county rights
- The association of railway communities
- The county tourism association

Service Provision

- The provision of inherited services
- Taking over all tasks from the county as a matter of prestige
- The dominance of the center onto local government
- The central funding for service provision declines
- Conflicts with the county

Central-Local Relations—Normative Subsidies

- The requirement of hundreds of types of normatives/sophisticated subsidy systems
- It has nothing to do with actual costs
- It is changed year in year out
- It confuses the evaluation of annual growth
- It cannot be precisely matched with services
- There are unexpected jumps in the volume of subsidies, at times
- Lack of predictability

Local Resources—Local Taxes

- There is no planned tax policy/tax strategy
- The level of operations is funded by increasing local taxes and the revenues of institutions
- Earmarking distorts proportions
- Vehicle tax collection is difficult owing to shortage of information
- Building tax is the most unreliably estimated tax type
- Local business tax—substantial growth, but rigid system with little differentiation

The Institution System of Service Provision

- Service providers are typically budget organizations



Innovative forms:

- Municipal service maps
- Introduction of indicators
- Revision of public employees' status
- Foundation of non-profit institutions
- Privatization
- Public utilities in concession
- Outsourcing to external service providers
- Foundation of local government owned business entities
- Tendering

Motives of institution transformation:

- Commercial opportunities
- Pre-condition for winning subsidies
- Individual financial interests

Institutional opportunities depending on executive personalities

Solving of new type problems in service provision:

- The professional/financial supervision by the local government is infringed
- Supervision drifts onto a political plane
- Conflict of interest in decision making
- Former institutional mechanisms have survived
- Transformed institutions expend their assets

Sector Analyses

- Health: specialized services at county level
- Public education: innovative forms
- Schooling: rejects market criteria
- Social service provision: oversized institutions
- Public utilities: partly privatized
- Concession-based

Municipal Investments

- Low level of investments
- There is no investment strategy
- Innovative forms:
  - Re-investment of capital gain into the investment
  - Utilization of a capital budget
  - Business investments
- Priority of technical areas
- Fragmented asset management
- Good/bad investment classifies



### Asset Management

- Substantial loss of capital over recent years
- The judgment on assets changed frequently
- The local governmental practice of asset evaluation is not adequate
- Lack of necessary data in registries
- Assets are not sufficiently differentiated
- Creation of a decree on assets in 1998
- Asset management organization is fragmented, lacks a concept

# FINANCIAL MANAGEMENT IN HUNGARIAN LOCAL GOVERNMENTS:

## THE CASE OF SZOLNOK

### INTRODUCTION

#### *Regional Conditions and Economic Processes*

Szolnok is a city with county rights. Situated between the northeastern and the southeastern regions, the city would like to belong to both but in reality belongs to neither. At the same time these regions have been organized with their own regional centers (Miskolc, Debrecen and Nyíregyháza share the former, Szeged dominates the latter), and Szolnok finds it difficult to develop its own role. The population of Szolnok has recently grown considerably and its infrastructure was developed rapidly in order to meet the boom. With its 120 year history as a mislabeled agricultural market town, Szolnok is still striving to define its identity. Szolnok used to be a commercial and artisan town, ranked as an agricultural market city. Since the seventies, its population has doubled as tens of thousands of newcomers have settled in. However, the city has often fallen victim to the floods of the river Tisza, which is primarily why it does not have a well-preserved traditional city center and why it has developed a special public utility system and infrastructure.

**Table 1**  
**Comparative data from the six cities included in the study**

	<b>Szentes</b>	<b>Orosháza</b>	<b>Tata-</b>	<b>Nagyka-</b>	<b>Szolnok</b>	<b>Püspök-</b>
Area sq. km	353	202	91	148	187	187
Population	31,612	32,944	72,207	52,574	78,511	16,397
Total budget in 1998 (HUF	2,949,261	4,239,395	6,786,435	6,846,386	9,605,714	1,268,746
Total budget per capita	93.3	128.7	93.9	130.2	122.3	77.4

Placed between the Jazygian and Cumanian regions with their different and conflicting traditions, religions, and different financial and social positions, Szolnok has been always trying to define its own position; however, its central role was created artificially and the city has never been able to integrate into its environment. It is still quite a challenge for the city to earn recognition. People talk about the large regional developments with a sort of resignation, for the county system fragmented the regional attitudes. Due to infrastructural conditions, not

all potential municipalities are suitable candidates for becoming regional centers. And it will be politics that decide which ones will ultimately take on such roles.

The former local large factories have been dissolved (for example, the sugar refinery, paper factory, furniture factory, chemical works). They are currently trying to find new roles to play in the region. Some are now being reorganized by their foreign investors; for example, the French investor in the sugar refinery, and the Arab owner of the oil prospecting company have shed substantial social functions in order to make their jobs easier. These functions, including sports facilities, kindergartens and nursery schools, and residential areas, have subsequently been taken over by the local government. Getting rid of unproductive infrastructure has been typical of almost all of the new owners, an early sign that social sensitivity will be at best secondary to economic interests. Some of the spun-off institutions were put out for competitive bidding through the state privatization asset managing organizations, others were taken over by the municipality, and some of them are idle at present.

*There are some assets whose ownership is not clarified on account of some hiatus in the law; for instance the apartment buildings formerly belonging to the sugar factory used to be registered in the company books. It is now in question whether they are owned by the state or not; currently there is no owner, there is no regulation, and the houses remain vacant.*

On the whole, Szolnok has received an insignificant amount of foreign productive investment. However, the growth of small and medium sized enterprises is considered an achievement. It is also regarded a substantial achievement that since 1990 the local tax revenue has increased from HUF 60 million to HUF 1.5 billion, within the HUF 5 billion budget of 1990 and the almost HUF 10 billion budget of 1998.

According to municipal records, half of the local business tax comes from sixteen enterprises. The municipality regularly contacts these entrepreneurs in order to get them involved in the affairs of the city.

*Relations are maintained partly through the entrepreneurs' clubs. In addition, the city hall sometimes sends personal invitations to the best entrepreneurs for discussions and consultations on various matters. Also, there is an economic Pro Urbe prize to be awarded to enterprises by the city—rather typically, for years there was no one deserving of it until it was recently awarded to the paper factory.*

By creating general municipal arrangement plans, Szolnok has made preparations for the reception of entrepreneurs; if they come the city can show them a clear picture of the city.

Locals hope that in the future there may be a better chance of foreign direct investment coming to the area; in the cities located closer to the western border there are no longer such ample supplies of labor as in Szolnok, where there is a highly qualified labor force as well as an adequate cultural background (including a theater, bilingual secondary schools, and so on). And of course there is the immense railway infrastructure; the second largest airport of Hungary, also located in Szolnok; and certain inland waterway connections also available from the city.

On the other hand, the local public utility network is incomplete (there is a 76 percent sewerage network coverage), and the public road network is rudimentary or obsolete (the city does not even dream of a motorway and 160 km of the local public roads are still dirt roads). One of the basic elements for further improvements is the construction of the Szolnok-Albertirsa highway to link Szolnok with Budapest, which, for the time being, is a mere plan.

*By the year 2000, the sewage system will be complete. The City Council has also approved a road program, depending on the available finances.*

Another problem is that there is no higher education center in the city, nor any important research center that could make Szolnok attractive to potential investors. These factors also have an impact on the composition of the population of the city: Szolnok is a good source of intellectuals (there are many good secondary schools) but it is not good at retaining them.

The first concern of prospective investors is whether the direct requirements of production are met; the second is the quality of the municipality and its supply of utilities and other facilities. The local government, however, is mostly interested in the potential employment as well as local taxation which, in turn, is related to the issues of the land, facilities and improvements required by the investor.

It has been found that it is more attractive for an investor to obtain land cheaply at first and then pay local taxes later.

*Some large companies have been consistently interested in investing in Szolnok, such as Audi, but Szolnok is only one of the six locations selected as potential premises by Audi, so the city will have to compete against the other five locations to secure Audi's investment.*

## Summary

Szolnok is in a midway position between two regions which often makes assuming a central role difficult.



Its artificially created central role is a permanent resource of conflicts.  
Former large factories have fallen apart.

Recently only a negligible size of productive capital has appeared in the city.

The city has a highly qualified labor force.

Local infrastructure (particularly the network of roads) is obsolete and insufficient.

### ***Regional Cooperation***

With the leadership of Szolnok, the regional association was established as far back as 1991, with 27 members, four of which are municipalities located outside the city. The Association was established for the purpose of managing and resolving local problems and tensions as they come up. The Association covers the actual region in which common problems have been arising on a regular basis. This formation is currently being turned into a cooperative association of municipalities in the region, which then may become a member of the regional development council as well.

Szolnok belongs to the statistical sub-region system of which it forms one sub-region together with 12 other municipalities. Typical topics of the regional consultations include public services and health; a recent addition to the agenda has been the issue of the development of regional bicycle roads. The law does not prescribe obligatory association but there are certain services which must be performed on a regional basis, such as the fire brigade. Having seen the difficulties of region-based service provision, some of the local leaders doubt whether this is really the direction to take in the future.

One specific attempt at regional cooperation in service provision was that local governments should pay Szolnok the amount that the city spends on children attending Szolnok schools from neighboring communities. The idea raised such indignation that it almost led to the collapse of potential cooperation. Ultimately the amount under discussion was so small that Szolnok renounced its claim.

Nevertheless, the problem has not died; later central normative transfers included a subsidy for commuting pupils, which still does not cover actual extra costs to the city.

Although the decision making authority in the Regional Development Council is fragmented—according to the locals—it is important that the decisions are made locally and funds are managed locally, where it is obviously better known what is really required than in,

for instance, the Central Environment Protection Fund (KKA).

Bargaining in the Council is permanent; Szolnok may substantially tap targeted and earmarked subsidies, and in exchange it provides similar amounts of assistance to the depressed regions (Tiszazug, Kunság) in their obtaining matching grants (HUF 200 million annually). Participants in the Council, however, tend to admit that the Council potentially raises conflicts between the city with county rights and “the others”.

According to local leaders, the regional development subsidy, however mistakenly or carelessly granted, is very well used and is indeed badly needed, since the region is very disadvantaged. Later on, however, a strong differentiation will need to be applied according to the functional differences. Development funds, along with grants, should be aimed at specialized service provision and ensuring services to citizens. At present this is not yet the case, so municipalities wish to do those activities for which grants are available.

Also in 1991, Szolnok joined the Association of Cities with County Rights, which plays a role in sectoral interest reconciliation and coordination (for example of the differentiated normative subsidy for the commuting pupils, achieved in 1996). Szolnok is also a member of the Association of Railway Communities, comprised of Hungarian towns with large railway facilities as well as smaller communities along secondary railway lines. This organization is centered around MÁV, and is seeking opportunities for cooperation through railway related problems.

For instance, with the participation of the County, MÁV, two enterprises and the local government, a limited liability company called LOGISZOL Kft. has been founded in Szolnok with the task of establishing a logistics center in Szolnok and developing the possible ways and means for the utilization of the southern industrial zone.

Szolnok is a member of the *County Tourism Association* along with a dozen other municipalities of the neighborhood; the organization discusses issues relating to tourism. The association aims to develop the sector, as well as carry out collective tourism marketing activities.

## SERVICE PROVISION

Local governments, including Szolnok—according to some of the local leaders—assume additional functions in their happiness at finally being autonomous. Szolnok and the county also have fallen into this trap; subsidies for services used to be available in more ample supply, allowing for “pinching off a sum here and there,” but this is no longer the

case.

This kind of over-commitment, however, is not only an adverse result of independence; it is also an indication of some political attitudes. Undertaking politically profitable services, however, does not always take into account the realities of the budget. For instance, it has become clear that the over-ambitiously undertaken public utility projects, such as the gas projects, roads, sewage, or education, sometimes place almost unbearable burdens even on small communities.

The Act on Local Governments only wrote local tradition into law; the services required by the Act have been and will probably continue to be provided by local governments. Szolnok is also coping with a set of inherited functions and services. The city has not separated mandatory from voluntary services and Szolnok continues to provide the services it has inherited along the institutions and apparatus pertaining to them.

According to the local government leaders, to talk about mandatory and non-mandatory services is to invent a difference between the two. The two are not really separated, since the financing of mandatory services is not ensured, and a local government cannot ignore an area such as education (although there are no specific sanctions against a local government that fails to provide these services). The services listed above are part of the regular operation of a normal municipality, and must be provided by the local government.

On the other hand, local governments feel that inflation spontaneously reduces their ability to provide services. Despite the apparently increasing central transfers, subsidies for some areas have drastically declined (for example, there are hardly any subsidies available for sports) and the increasing number of additional services imposed on local governments (such as new child and youth protection tasks, construction authority duties) are not accompanied by additional funding to local governments, although it is required by the Local Government Act.

For instance, the function of operating the fire brigade has recently been assigned to the local governments, which will entail enormous maintenance and investment costs in addition to the operating expenses, since central funding is not sufficient even for their essential assets.

The state has moved out of the area of sports, and former large enterprises have been wound up, so the local government has been left alone with the task of maintaining the sports facilities. And it is not easy to find businesses to sponsor sportsmen other than champion hopefuls. Consequently, certain branches of sports are dying for lack of subsidy.

There is also a local opinion that the central government can always divest itself of responsibilities, under the pretext of giving “autonomy”. For instance, the fire brigade has no real power so the central government is willing to delegate that responsibility. However, the central government has good reasons for not handing over the police; this is despite the fact that local governments subsidize the police (yet have no say in their operations).

On the whole, according to the Szolnok finance officer, some 40 percent of the budget is spent on mandatory services.

For Szolnok, as a city with county rights, it was a matter of prestige to take over as much from the county as possible. Szolnok took over everything; only the hospital, the museum and the library were left with the county, but the city contributes to the operation of these institutions as well (for instance, the city funds the maintenance of the dental and the pediatrician duty service).

The permanent tug-of-war with the county is still going on and the relationship between the two has even deteriorated somewhat, as is evidenced in the lawsuit underway concerning use of the city's culture hall and its activities.

The city renewed the former culture hall as a public service corporation and it intends to carry out community activities in this organizational form but with more flexible institutional options. The county is not willing to accept this, for according to the provisions of the law—so the county maintains—the city should operate the culture hall as a budgetary organization. Since Szolnok is not doing so, the county as the owner is claiming back the right to run the culture hall. The culture hall may be used by the entity that provides the services: currently the city is using the county-owned institution free of charge.

A serious problem for the county is that in the former system, central targeted subsidies flowed to the local governments through the counties and so the county used to be able to manage these funds quite flexibly (it could subsidize local investments with fixed central funds plus loans—the repayment of which was guaranteed by the state) but that option has disappeared by now. Today the county has suddenly run out of money, or, more precisely, its funding structure is similar to that of the local governments. In this difficult situation the county is making efforts to recover some of its former privileges, for example, the ownership of public institutions (by arguing that the loans were initially taken out by the county).

The legislation on ownership and scopes of authority that has evolved to date complicates the position of counties since if the local government undertakes to perform a function, the county, which is the owner, is obliged to maintain the institution for the local government. The culture hall in Szolnok is an illustration of this: the county, as the owner,

cannot do just anything it wants with it. Although the law provides so, this example demonstrates that professional and financial regulations are far from being harmonized.

There are unceasing disputes about asset management issues; for instance the theater, which is owned and operated by the city, is not subsidized by the county despite the fact that the city earlier contributed to the renovation of the library and of the museum, which belong to the county.

Originally, a long term agreement should have been concluded on subsidies between the county and the city, but due to constantly decreasing funds, they have mutually withdrawn from that plan.

On the whole, program budgeting, introduced in Szolnok four years ago and being constantly developed, has led to substantial changes in terms of efficiency and transparency of service provision, in the definition of specific activities, and in attitudes.

The choice of services to undertake in Szolnok is also influenced by the fact that the city wishes to become a cultural center, so it is providing increased subsidies for culture.

For example, the city has helped to accommodate the cultural ministry's school. The city supports a number of orchestras (the internationally renowned Liszt Ferenc Orchestra headed by Rolla János, and the Szolnok Symphony Orchestra), and operates a teachers' hostel and actors' apartment building.

## **Summary**

The Szolnok local government continues to provide services it has traditionally provided.

When undertaking responsibilities, it was a matter of prestige to take all services from the county.

The elbow-room for the municipality is shrinking as the central government delegates new services to the local government.

Central financing of municipal services has been declining.

The central government, using its power over the local ones, delegates those responsibilities that it finds inconvenient.

The center sets groups whom it supports against one another.

Conflicts intensify between the city and the county.

The introduction of program budgeting has led to substantial changes in terms of efficiency and transparency of service provision as well as of the definition of specific activities.

## **CENTRAL/LOCAL RELATIONS**

### ***Normative Transfers***

Normative transfers are a key area of central/local relations, one highly affected by a specific tension due to the differences between planning systems with special motivations, interests and techniques. The planning system between the central and local levels is revenues oriented, operated by the regulation of resources. Local level planning, however, is a leveling out technique and regulates expenditures rather than resources. The two systems interact at the level of the local government, which distributes centrally transferred resources to services provided by institutions.

The role of local governments, however, seems to have become more difficult recently in the environment of two kinds of planning because the central government, which creates the regulations and guidelines for service provision, ensures only a part of necessary financing. Institutions must nevertheless perform what they are required to do and bill the local government. The "bill" is only partially covered by central transfers, and the transfers themselves are increasingly earmarked.

A few years ago it seemed that the intention of the central government was to create a sophisticated system of central subsidies that would be able to respond to a variety of situations by introducing a large number of normative transfers. This system, however, is dwindling.

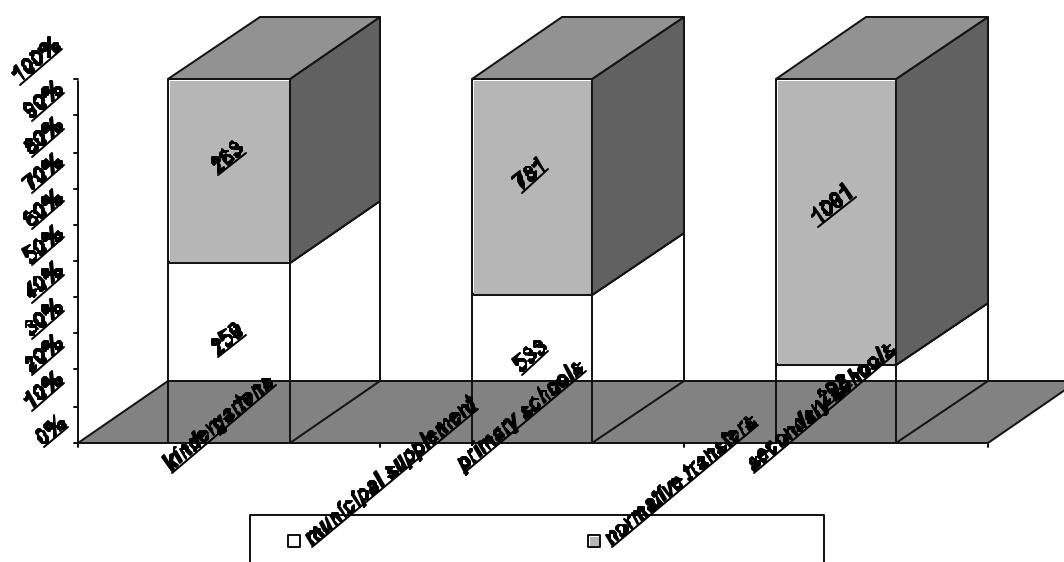
In 1997 there were 266 normative subsidies; 1998 there were only about 100; in 1999 there will be some 40 normative subsidies divided into 20 main categories. It has to be noted that current normatives earlier were centralized items and normatives are better for local governments because they can be spent freely. Even though normatives require fastidious calculation, the central government can better pursue its subsidy policy through the large number of normatives by more accurately defining services and matching resources. Currently, however, the central government tends to say "it is in the normative" whenever the local level wants it to provide resources for new services. This happened when PIT was



shared with local governments in 1995 and the center said it included a couple of subsidies.

It is impossible to compare subsidies for a given area in different years since there are so many substantive and formal changes each year that the subsidies cannot be compared. Types of normatives change each year as well as the information that is to be included when calculating normative transfers. At the same time, however, both local institutions and politicians require the local government staff to quantify “increasing” normatives in an institutions and services break down. That normative transfers are unpredictable and impossible to calculate creates tensions both in financial management and in organization. Another problem is that if one looks at the actual expenditures of a service, the normative transfer itself has very little to do with the actual provision of the service as the normative transfer element in the finances of various services substantially differs.

**Figure 1**  
Resources for educational institutions (1998 estimates in HUF million)



The estimated proportion of cost covered by state subsidies for various services provided in Szolnok are as follows:

Social provision	60-70 percent
Education	60 percent
Extreme values:	
Secondary school hostel	80 percent
Nursery school	40 percent

In fact it is only just if it is channeled to the recipient since in this way a service provider

relation emerges. In its concrete amount it also provides a basis for comparison, for the service provider.

On the other hand, the service provision may differ to a degree of one to five. What costs one unit in Budapest may cost five units in Szolnok and vice versa; there are also substantial differences between the cost ratios of the local institutions. Normatives are stable in that they provide some subsidy for services on a permanent basis, however, their real value is declining. Table 2 shows the percent of operating costs covered by total central transfers and normative transfers respectively.

**Table 2**  
**Percent of operation costs covered by central resources**

	1993	1994	1995	1996	1997
Centrally regulated operational resources	78	72	77	70	66
Normative transfers	51	43	45	39	39

The uncertainty of the system is further increased by the fact that some of the normative subsidies are unexpectedly and substantially raised from one year to the next. An example of this was the significant increase of the normative subsidy for grammar school student hostel accommodation in 1997. Currently the hostel is almost self-sustaining as a result of the increased subsidy. However, the city was on the point of giving up its hostels when the subsidy was unexpectedly increased. In many cities they were actually closed down by the time the subsidy came in.

The system hides a number of additional critical points. For example, the provision of the regular child protection is a task recently assigned to the local government; it must be provided below a defined income level, half of it by the local government, the other half by the central authorities (in general, in social areas the contributions are usually 70 percent and 30 percent). The statutory threshold amount entitles some 10 percent of the population to the subsidy; in Szolnok this figure is 20 percent, due to the low income level. Any change of threshold could lead to a substantial increase or decrease in the amounts of money involved, further increasing the uncertainty of the system.

With respect to the normative subsidies both the local government and its institutions are interested in filling up the institution. Once an institution exists, it should be operating at full capacity. This is decidedly contrary to the principle of service provision on the basis of actual demand. For instance, if there is a temporary home for families (a statutory requirement since 1998), then due to the financing regulations on normatives, it should be kept full as much as possible, whether or not there are families in need.



There is also a normative for the education of ethnic minorities even though the local government violates the law if it collects data on ethnic background.

### Summary

The several hundred types of normative transfers that used to be present in municipal finances signaled the need for a sophisticated supporting system; their number, however, has been reduced to a few dozen.

The amount of normatives has little to do with actual costs since the normative proportions of finances widely differs.

Normatives are transferred on the basis of a system that changes every year.

Regular changes in normatives make it difficult to evaluate annual increases.

Normatives received cannot be directly matched to services.

Occasionally the amounts of normative transfers sharply change.

On the whole, the normative transfers system is unpredictable and incalculable, making financial management uncertain.

## LOCAL RESOURCES AND TAX POLICY

**Table 3**  
**Local tax revenues (HUF thousand)**

	1993		1994		1995		1996		1997		1998
Type of tax	Estimate	Actual	Estimate	Actual	Estimate	Actual	Estimate	Actual	Estimate	Actual	Estimate
Building tax	30,000	81,600	80,000	36,684	57,000	57,026	122,000	61,658	80,000	129,200	130,000
Business tax	80,000	242,932	240,000	245,781	203,000	372,495	380,000	641,871	680,000	787,787	920,000
Vehicle tax	30,208	25,793	25,000	26,298	23,000	19,327	40,000	45,907	49,000	46,700	49,000
Total tax revenues		350,325		308,763		443,848		749,436		963,687	

Each of the locally applicable tax types was introduced in 1992. We have not gathered any knowledge of the local tax policy or tax strategy during the interviews; however, municipal

management made it very clear that the given level of operation cannot be maintained, as it leads to the consumption of substantial volumes of the local assets.

It was also realized in Szolnok that the increasing burden of service provision responsibility borne by the local government can be balanced by increasing local tax revenues. There is also a substantial increase in revenues from the base activities of institutions (these grew almost seven times in real terms in a period of five years). These are supposed to be the possible directions for progress.

Between 1990 and 1998, the local tax revenue increased from HUF 60 million to HUF 1.5 billion (within the 5 billion budget of 1990 and the almost 10 billion budget in 1998). This represents an increase from 1 percent to almost 10 percent of the total income of the local government.

Over the past 5 years the total amount of the local taxes has almost tripled while the total income of the budget is 2.3 times as large.

The growth of the share of business tax in all tax revenues has been especially dynamic, as it has increased to 7.6 percent from 5.3 percent five years ago and its volume has almost quadrupled. In connection with the tax revenue plans, this tax revenue has been found to be the one that each year is substantially larger than expected.

The local government has found that half of the local tax comes from sixteen enterprises, and it makes efforts to regularly involve these businesses in the affairs of the city.

The assignment of a certain percentage of the tax to local governmental funds or tasks serves the purpose of earmarking.

The taxpayer may earmark 10 percent of the tax he pays, which amount is transferred to local governmental funds with defined purposes, and if possible, may even be assigned to a defined activity. Another possibility is the write-off at the end of the year of the amounts contributed on a voluntary basis to the funds, up to 50 percent of the amounts of such contributions.

The local financial management questions the usefulness of the above solution. They think that the incoming earmarked amounts are lost in a large pool from which they will be spent on goals already defined by the local government; that is, the funds so highlighted do not constitute additional funding sources for the defined goals.

If some interest group carries out excessively strong lobbying activities, it can send out a meaningful message in the long run but at the same time it distorts healthy proportions of

local government activities.

On the other hand, it creates a false appearance that the taxpayer makes paying tax subject to the subsidization of the goals he considers desirable. This type of system of earmarking would be good—according to local opinion—if contributions were additional amounts to statutory taxes.

The volume of tax arrears is not considered large locally; tax compliance is considered good, despite the fact that arrears amount to HUF 60 million (which *is*, however, still a lot smaller than it was in 1996). By looking at the mix of arrears, one sees that a substantial part (80 percent) of arrears is accumulated by businesses having been or being liquidated and is uncollectable.

**Table 4**  
**Local tax compliance**

	1993	1994	1995	1996	1997
Total tax arrears (HUF thousand)	29,941	37,927	58,738	80,335	60,520
Fines for paying late collected (HUF thousand)	2,738	7,189	21,960	18,126	17,667
Number of forced collections	1,501	1,782	2,538	3,425	3,940

Until 1997 the law set a ceiling on vehicle tax (HUF 400/100kg, of which HUF 200 is retained locally); after 1998, however, local governments may impose increased taxes up to a maximum of HUF 800/kg) and the amounts so collected may be retained locally. Szolnok does not make use of this opportunity.

In Szolnok tax collection is hindered by a fundamental obstacle, in that they find it difficult to trace the owners, for lack of appropriate updated information.

One local government employee was permitted to work in the data base of the police for one year to register changes but even this form of cooperation has come to an end. The police registry is not made available to for the local government.

The collection of the vehicle tax is much more difficult than that of other taxes. There is a relatively large proportion of receivables and tax arrears.

The building tax in Szolnok is collected in a self-reporting system, and is determined on the basis of floor area. Collection on the basis of the value of the buildings could be an alternative to the existing system. This is prevented, however, because of the lack of a registry of buildings by market value, as well as experts experienced in asset valuation.

Of the approximately 3,600 Hungarian local governments, a total of 2,464 have introduced local tax; 608 of them calculate on the basis of natural indicators; two municipalities (Nyíregyháza and Németskér) use value data (adjusted market value = 50 percent of the calculated value) in the imposition of the tax. In Nyíregyháza this system is made operable by cooperation between the duties office and the tax office; the value established for the imposition of the duty is used for the purposes of taxation as well.

In 1996 there was an attempt to regulate taxation by value through the introduction of centrally established value categories (on the basis of real estate types, geographical location, construction technology, etc.).

According to local opinion, the rates of the applicable tax would be materially increased by taxation by value, but it would not increase the collectable amount. Local government staff

dislike the introduction of a system that would impose a heavier burden on the local taxpayer and which they feel would be complicated and subjective. They argue that in Hungary there is no tradition of taxing in this way.

In Szolnok, building tax has always been the type of tax that is estimated with the most uncertainty. This is indicated by the high degree of uncertainty that is found between the budgets and the actual tax revenues each year.

Besides inadequate recording systems, building taxation is uncertain because of changes in tax regulations in terms of exemptions and categories of use.

Buildings used for production are exempted from taxation. If, however, the building is used for a different purpose another year, the tax authority has to recategorize the building. Although taxation itself is based on tax returns, categorization of subjects of taxation and collection is rather an investigative work because of frequent changes.

The tax affects only commercial property. The rate is only HUF 200/m<sup>2</sup>, far below the potential HUF 900/m<sup>2</sup>. It has been resolutely kept low for reasons of the burden bearing capacities, traditions and political considerations, as well as because of the enterprise tax, which is also imposed on the same group of taxpayers.

The tax staff also believe that the taxation of homes would be more difficult, as there are still a multitude of tax exemptions in effect for decades to come. They also think this source would be very heavy on the population while it would not provide more to the local government than an estimated HUF 40 million tax revenue, according to their simulations).

Tax returns are checked by calling on everyone at home. All accessible ways and means of tax collection are employed to ensure tax collection (personal influence, letters, visits taxpayers on-site, garnishment from the payroll, bank accounts).

The tax per square meter is increased each year.

The business tax accounts for 80 percent of local tax revenues. In Szolnok the tax rate is currently 1.3 percent, and the appropriate cost elements may be written off.

There is no tax bracket system in Szolnok, and only some preferences are applied (primarily aimed to promote social/welfare assistance).

## Summary

In Szolnok there is no planned tax policy/tax strategy.

The local government has realized that the level of operations can only be funded by increasing local taxes and the institutional revenue.

In local experience, earmarking tax payments distorts proportions of support and disturbs the willingness to pay taxes.

Vehicle tax collection is difficult owing to shortage of information.

Building tax is the most unreliably estimated type of tax.

Local business tax revenues have grown substantially; however, this type of tax is a rigid system with little differentiation.

## **INSTITUTIONS OF SERVICE PROVISION**

A substantial range of municipal services is provided by local governmental institutions. However, new forms and modes of service provision have also appeared, such as:

The compilation of city supply maps and their use in the case of some services:

The drawing of the supply maps is related to the introduction of program budgeting.

The map addresses the condition of the city in various areas (roads, pavements, education, health, social policy) in the spirit of program budgeting. The studies prepared on these areas help inform decisions on municipal services.

Utilization of indicators for the measurement of the levels of service provision:

The introduction of indicators is a process that has been going on since 1995, and is being developed as part of the program budgeting effort. 1998 is the year of the full-fledged introduction of indicators, although their role is still not dominant in the decision making process. Some city leaders counsel caution in relying solely on indicators when making important decisions.

The measurement of service provision is in effect based on the quantification of natural factors of institutions (relative proportions of headcount, overheads, floor area etc.) and there is no elaborated indicator system in Szolnok for the measurement of the quality of performance. Indicators, however, are perceptibly assisting the operation of the institutions even by their very existence, in part

providing publicity for measurability and its criteria and in part by concentrating on quality.

The revision—in places—of the public employee positions (for example, half of the actors/actresses receive their salaries as contracted entrepreneurs).

Reorganization of service provision in non-profit institutional framework:

The culture hall has been transformed into a public service corporation, which may have other revenues (business, sponsorship, competitive bidding etc.) and as a non-profit institution, is granted preferences (primarily VAT). The Child and Youth Foundation was established for the purpose of retaining the former Communist Youth Association's assets in Szolnok, utilizing the former camps and resorts and is involved in providing recreation services. It operates a substantial capital.

Public utilities operated by concession companies.

Privatization.

Outsourcing of some services (e.g., The operation of the cemetery has been taken over by the church).

Establishment of business entities fully owned by the local government:

The local government set up a municipally owned limited liability company (Szollak Kft.) for the management of the local government owned homes (1/3 of the former stock).

Allocation through bidding of some subsidies (for example, public safety or sports).

According to local experts, the personality of the institution manager is crucial in adopting new types of solutions. Even in budgetary institutions, almost all requirements for innovative operations are in place, the locals say; see for instance the example of Szolnok's theater.

Respondents saw the following motives for removing service provision from the mayor's office:

There are more market oriented solutions.

An institution may be the pre-condition for obtaining a grant.

The decision maker is personally and financially interested in the new solution.

The removal of a service from the traditional budgetary institutional form raises a number of new types of problems for the local government:

The professional and financial supervisory authority of the local government diminishes considerably:

An independent institution provides only as much insight into its financial management as is necessary or enforced by law. This is usually too little for tracking the actual activities of the institution. One example is the price bargaining of the public services where the public utility company tries to charge a price calculated in accordance with the provisions of the law, but the local government finds it unreasonably high. If the company does not violate the accounting law with its calculations, the local government is obliged by the pricing law to accept the price submitted by the company, and if the local government applies a lower consumer price, the difference must be paid by the municipality to the service provider company. There is a specific case mentioned in the local government where it is known from private information sources that the price so accepted also covers other costs of the firm. The enterprise can recover these costs, since the local government cannot screen such manipulations.

The supervisory sphere shifts onto the political plane:

The supervision of the services removed from the mayor's office is done by the local government through a supervisory board, or a board of trustees assembled in accordance with the political parity. Professional considerations are disregarded or at least reduced to secondary importance in the decision making process.

Conflicts of interest develop among the decision makers supervising the institutions:

In Szolnok, delegating local governmental representatives to the supervisory boards of municipally owned companies is an established practice, but this may lead to confusion of roles. Individuals representing the local government and the population will sometimes have to act as a decision maker in charge of the proper operation of the given company, and so often they have to argue against their own previous decisions. The situation is aggravated by the fact that such individuals usually receive salaries in each of their two capacities.





Earlier budgetary institutional mechanisms linger on:

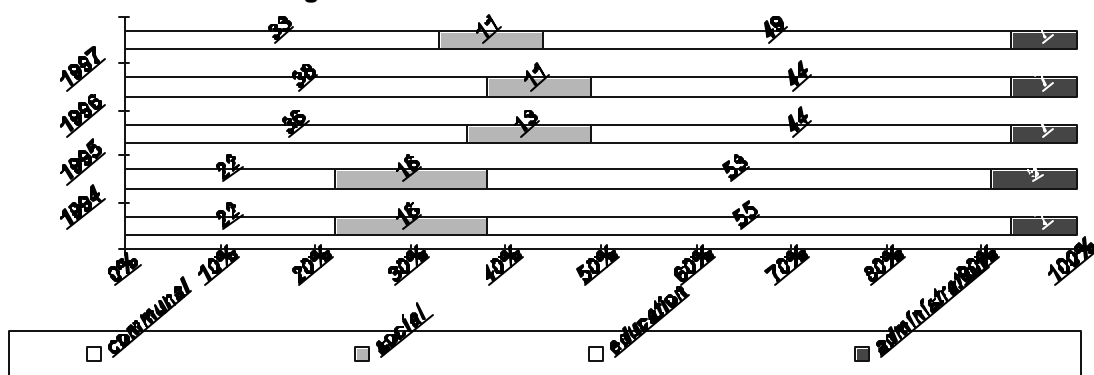
Although the service provider in the process of becoming an independent institution is removed from the municipal budget, in many cases it is still inclined to act as though it were still a budgetary institution, directly depending on transfers from the local government in its day-to-day operations. In a financial crisis situation, the head of such an institution tends to turn to the local government for assistance as the solution to the problem, asking for transfers. This situation arises in the case of former local governmental institutions, often because of participants who had become used to the former mechanisms.

The transformed institution gradually consumes the capital it received but at the same time cannot perform its duties:

One version of this situation is when the institution is set up without properly reviewing its market options and assets and thus is doomed to failure from the start. This has occurred in some instances in Szolnok as well: Városfejlesztés Rt. (City Development Co.) was set up as a local government business designed to create a vision for Szolnok as well as development plans (for instance to prepare the creation of an industrial park). But no appropriate financial resources were assigned, so the company has shed this activity and is trying to sustain itself by selling local governmental property, constantly consuming its assets for its operation.

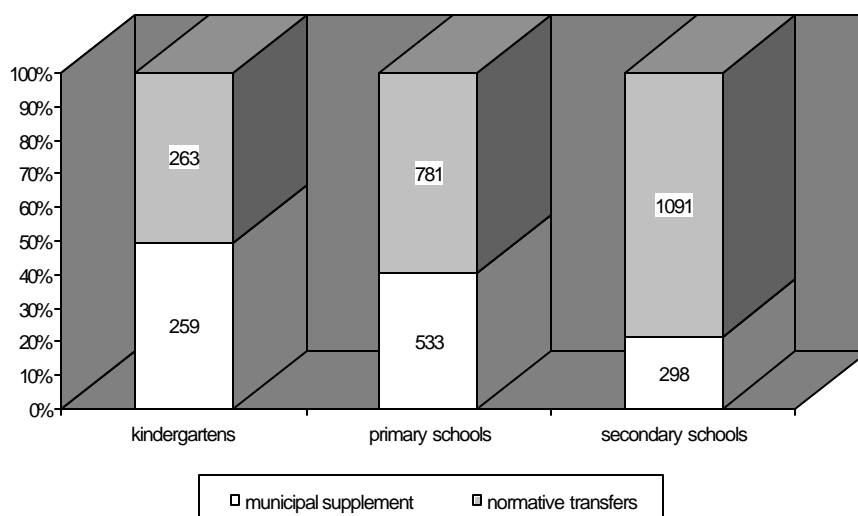
## Sector Analyses

Figure 2  
Share of sectors in the budget





**Figure 3**  
**Revenue structure of institutions (1998 estimates)**



## Health care

The provision of health services is financed jointly by the Social Security Fund and the city. Doctors work in part as public employees, in part as contracted entrepreneurs. In this system the social security pays the public salaries and contract doctors, while the city covers the operating costs of the polyclinics of the city. Central appropriation may be requested to procure equipment, otherwise the city may finance it from its Health Fund.

## Communal Sector

According to the model, services are provided on four different levels: (1) the mayor's office, (2) local governmental institutions, (3) partly separate institutions subordinated to the local governmental institutions and (4) external organizations:

- 1. Services provided by the mayor's office** include the services of the Families' Institute, a former independent local governmental institution, has been taken over by the mayor's office (for example, wedding ceremonies and naming ceremonies).
- 2. Services provided by local governmental institutions** include the theater, the "Sunshine' Children's House" (children's programs, artisan workshops) and the municipal library.

- 3. Services provided by partially separate institutions** include the Musical Arts Center of Szolnok /Szolnoki Zeneművészeti Központ/ (a joint institution of three separately managed institutions) which has been subordinated to the Kodály Zoltán Musical Elementary School /Zeneművészeti Általános Iskola/ as a separate budgetary institution, in a 'partly independent' status as regards its financial management.
- 4. Services provided by external organizations** include independent founded by the organizations local government (the City Culture Center Public Service Corporation /Városi Művelődési Központ Kht/; the municipal television; the Child and Youth Foundation/Gyermek és Ifjúsági Alapítvány/, which organizes camping; Galery Friend's Association/ Galéria Baráti Kör Egyesület/Alapítvány, which manages the Szolnok artists community). This category also includes other organizations, typically in a subsidy relation (for example, the subsidized newspapers).

With (1) and (2) service provision is based on the deed of foundation in cases, while (4) is in a contractual relation with the local government. In the case of type (3) the two institutions sign a cooperation agreement.

Decisions about budgetary subsidies, the foundation of the institution and the appointment of the director are made by the City Council, and in cases (1)-(2)-(3) the day-to-day operation is supervised by the mayor's office. Professional supervision is carried out by the Department of Human Public Services and the financial supervision is carried out by the Economic Department, which calls institutions to account for their affairs.

In case (4), if the local government is also an owner within the institution, usually elected representatives, the mayor or the notary or external experts serve on the board of trustees or on the supervisory board and the decision making, supervisory and controlling authority is totally removed from the office.

This is exactly the source of conflicts since the mayor's office cannot professionally control the financial and asset management of the institutions.

Typically, the assets required for the provision of the service belong to the local government in the first three types while in type (4) the assets wholly or partially belong to the independent institutions (for example, the three resort facilities managed by the Child and Youth Foundation have been fully transferred into its ownership). The founding capital of the municipally owned public service corporation was cash and some assets; the land on which

it was built is owned by the city, but the building itself belongs to the county. The contracts for service provision cover one year for a number of organized events.

There is no performance or quality measurement incorporated in the system. The contracts are signed by the mayor and are public in principle. The balance sheets of the institutions founded/owned by the local government are submitted to the office's finance agency.

On the office's part, the professional supervision is performed by the community education sub-department operating within the department as well as the department itself. The control activity is based on personal presence (on-site visits) and natural/numerical indicators. Theoretically complaints may be recorded in the complaints book by the complainers, and on site supervisions performed by the local government are recorded in the control log.

The pricing function is transferred by the local government to the service providers even in its own budgetary institutions (for example, the theater).

As for the financial management of institutions, in the case of the public service corporation the practice of project management has been introduced, with revenue and expenditure calculations for each event, strictly permitting only organizations that are profitable or break even.

The financial management of the theater has become known as the "Szolnok model". The new director has substantially transformed the employee staff who, in legal terms, used to be public employees; as few as 20 of them remained so out of the former 190. He contracted out the majority of the functions (stage property, costumes, catering, ticket sales, ushering etc.). With substantial sponsorship and municipal subsidies and institutional savings the theater pays the best salaries nationwide to the best artists, who are individually contracted.

Depreciation does not appear in the budgetary financial management but as soon as the institution is out of this category, it will. In the case of a public service corporation it makes the operation of the culture hall definitely unprofitable. The situation is complicated by the fact that although funding the booked depreciation would be a task for the public service corporation, the real estate and assets for which it is booked is not owned by the public service corporation. From among the institutions the significance of the alternative services is decisive in the case of the public service corporation for this form makes almost any type of service providing activity possible and the revenues generated can be invested in the core activities of the institution with substantial preferences; the only criterion is that it should serve

public goals. Thus the public service corporation may earn substantial business revenues from parking charges or space utilization.

There is strong competition for the foundation involved in organizing camping for children since the market for recreation services has expanded considerably.

### **Education**

The city has reduced its educational function to some extent: certain schools have been closed down and more may follow.

According to local opinion the human sphere cannot make it under market conditions, and the market units of measurement do not provide a sufficient basis for decision making. They feel that they must be strongly self-assertive in this area, which is the reason why it is not bending to these arguments.

At the same time the new law on public education is threatening the entity that maintains such institutions: the National Medical Officer's Service (ANTSZ) is authorized to control appropriate indicators and regulations in schools and to apply sanctions. However, it is known to everyone that almost no school can comply with all these regulations—for instance, one that a certain number of owls to be kept in the laboratory collection.

### **Social Sector**

The sector analysis commissioned by the local government has arrived at the following conclusions on the quality of service provision, after a comprehensive analysis of the whole of the sector:

The city is characterized by a strongly concentrated service providing sector. The delegation of tasks to external actors has not yet taken place, thus the local government and its institutions alone must meet all demands. Nevertheless, the judgment formed of the service providers is very good even by national comparison, and their tenders for central development grants are successful.

The degree of the development and establishment of the system also entails a rigidity of the framework. There is a permanent and acute shortage of capacity in almost all areas.

Another deficiency of the system is that it is not flexible enough and does not respond to differentiated requirements and quality needs. Not only is merely improving service quality problematic but the operation of quality services is also difficult since the system was devised



for low standards of service provision.

*Care for the homeless.* This service is provided by the Human Service Provision Center (Humán Szolgáltató Központ) on the basis of its deed of foundation. The institution performs a wide range of social/welfare activities as it does not require a large staff and various services tend to interrelate.

For instance, the welfare law prescribes that unemployment services be supplemented with public work and family assistance services, making it reasonable to provide all these services within one institution.

The original family assistance profile, decreed in the deed of foundation, was supplemented with the provision of services for the homeless in 1991, with child welfare services and public service employment in 1997.

The additional services were introduced on the initiative of the institution, partly anticipating the provision of services later imposed on them by law. This does credit to the competency of the professional staff.

As a result of a recently completed audit of the whole of the social/welfare sector it was concluded that the institution is oversized, and assigned too many types of activities to be performed simultaneously, but the standards of the services are high. In this particular situation, the director himself is a source of conflict, in that he tends to give preference to some functions at the expense of others. For instance, at present there are too many programs to assist the homeless at the expense of the assistance provided to families.

The decision making responsibility is held by the head of the institution; the responsible professional supervisory authority is partly the Human Public Services Department which has taken on more of a consultative role, and the Social and Employment Committee which is in charge of professional controlling. This is supplemented, of course, by the office's legality and financial management supervision. The service provider being a budgetary organ, all of its assets belong to the local government.

Service provision through outsourcing still seems unlikely in Szolnok, one reason for which is the perceptible distrust on the part of the local government concerning external partners, partly owing to the weakness of potential local service providers (mainly non-profit, the majority of them struggle to survive).

As regards the whole of the sector, however, there are promising examples to the contrary; for instance, an elderly home is operating in the form of a public service corporation

and the rehabilitation of mentally handicapped is performed on an association basis.

The solution may lie in strengthening the non-profit organizations. Also, contractual guarantees could be elaborated to ensure service provision, and offset distrust on the part of the local government. Currently there is a program going on to research this option in Szolnok.

### **Fire department**

The operation of the fire brigade is prescribed by an itemized government decree, with detailed indicators of what is mandatory in which area. The professional supervision has continued to be performed by the county headquarters. Besides their normative type “earmarked” funding, the municipality provides them with five full time employees and some contributions to their operating costs.

### **Garbage Collection**

Garbage collection and disposal is performed by Rethmann, a German company on a contract basis. The contract is rather unfavorable for the local government as it ensures Rethmann a monopoly.

Forty-nine percent of the company is owned by the local government and the local government delegates representatives to the supervisory board. According to local opinion, however, it is very difficult to have an insight into the professional aspects of operation of the entity, and so monitoring is more or less impossible.

The site and the assets required for the service provision were transferred into the company’s ownership, the landfill was transferred for use, and the company undertook a commitment to construct a new one.

The contract is valid until the year 2025 (35 years). According to the syndicate contract Rethmann company was given a HUF 100 million stake, and it undertook to implement a development investment worth HUF 300 million to construct a new landfill worth HUF 440 million. A separate contract defines the contents, scope of the services, as well as a price adjustment clause in which the appropriate values have to be inserted every sixth month to arrive at the new prices.

An annex of the municipal sanitation decree forms the basis for the establishment of the annual local governmental “subsidy”; the annex specifies what has to be cleaned in the city, when and how many times. The prices are defined on the basis of these factors, reconciling the prices and costs. The relevant annual service provision contract is concluded by the



mayor's office, or the notary.

By now, the revision of the contract has become inevitable, although they are reluctant to create conflict with the company.

The performance measurement system has not yet been established and its development is limited by the syndicate contract. Control is exercised through the supervisory board, and through the cost calculations presented for the purposes of the annual price bargaining.

Fees are collected by Rethmann, and there are no arrears. According to the contract the local government guarantees the settlement of fees arrears, minus 5 percent covered by the company. The company is profitable and pays an annual dividend of HUF 3.5 million.

The construction of the landfill has just fallen due, for which the local government is to provide the site. One piece of land has been designated and purchased but the soil turned out to be high quality, and cannot be used for a landfill.

The rest of the services provided by Rethmann include public cleaning, park and road maintenance, flood and inland inundation protection activities and other services, such as sewage disposal.

### **Road Maintenance**

Road maintenance is done by Rethmann; according to the contract, the local government assigns a certain amount of work each year. The local government has undertaken a long term commitment, whereas it is already evident that it could secure less expensive offers for the given work. The long term agreement is regulated by the syndicate contract described in connection with the garbage collection function and the simultaneously concluded road maintenance contract. The concrete annual assignments are given by the local government in accordance with its annual program and Rethmann individually performs and issues the invoices.

Control is exercised by the local government as described above, through the supervisory board of the company. The assets are owned by Rethmann. Some negotiations have been initiated for the revision of the contract concluded for road maintenance but the local government's negotiating delegation usually loses against the German partner's strongly represented and well elaborated negotiation position. On the local governmental side, there are criticisms that inadequate negotiating partners are delegated, and that the representation of the issues should be transferred from a political plane to a professional level, but this has

not yet taken place. There is no performance measurement. The local government checks the performance of the work on-site.

### **Water, sewage and heating**

The provision of water, sewage and district heating services has been assigned to concessionaries, both of them of 35 years for operation and development and the ownership of all assets has been retained by the local government. The pricing authority power could make it possible to have the concession fee be incorporated in the tariffs, charging it to consumers but this has not been the case in Szolnok, and at present the tariffs contain a development block. The local government plans to establish a foundation to assist those in arrears with their public utility bills (water, sewerage, garbage collection, district heating).

The water and sewage services are provided by the Szolnok Water and Sewage Concession Plc. /Víz és Csatornamű Koncessziós Rt./ on a concession contract. The operation of the company is regarded a success in the city. The contracting parties have a good relationship and are mutually helpful. This has led to the development of a kind of a moral security between the parties. The whole of the assets required for the provision of the service is owned by the local government. The contract was concluded in 1996 for a period of 35 years. It provides for the development of the total water public utility property, for the construction and operation of a waste water treatment plant. The contract contains pricing clause which defines the annual tariff. One advantage of the applied formula is that it is simple, easy to understand and transparent. The tariff covers the costs on the basis of the formula.

The contract is public, in principle. The service providing contract was won through a tendering procedure. The company submits an annual cost calculation on the basis of which the local government defines the tariff. The contract was concluded in a tendering procedure and it was preceded by thorough preparation. The quality of the service is controlled by the ANTSZ on the basis of laboratory analyses.

The tariffs are collected by the company, the arrears are the responsibility of the company and are usually low. The tariff covers the costs of the service provision. The tariff includes a development block (a value of 10 to 20 percent) which is withdrawn by the local government over the three year period while the development project is underway, to cover the costs of the sewage treatment plant. The service is a region-wide one; the company supplies 14 communities.

### **Summary**

Currently in Szolnok, the service provider is typically a budget institution.

In the system of service providing institutions some innovations have been introduced:

- Drawing maps of service coverage of the city
- Introducing service provision indicators
- Review of public employees' status
- Founding non-profit institutions
- Privatization
- Utilities in concession
- Contracting services out
- Establishing municipally owned businesses
- Tendering services

Restructuring local service providing institutions is motivated by several factors, of which the main ones in Szolnok are:

- Market demand
- Certain institutional forms are grant requirements
- Personal financial interest of the decision maker

According to local experience, possibilities for institutions largely depend on the personal qualities of the institution head.

Innovative institutional solutions raise a range of new problems in service provision:

- Professional/financial control by the municipality is impaired
- Control becomes a political issue
- Conflict of interest in decision making
- Earlier institutional mechanisms survive
- The restructured institution consumes its assets

In Szolnok, according to research on the service provision sector, the institutional background of service provision is fairly varied, with the following sector specific features:

<i>Health care</i>	Base care is provided by the city
<i>Community and education</i>	Innovative forms have emerged
<i>Education</i>	Tends to reject market criteria
<i>Social provisions</i>	Provided by mammoth budget institutions
<i>Utilities</i>	Partially privatized or in concession

## INVESTMENTS

In Szolnok the investment level has been approximately 5-6 percent over the past five years. This level has increased since 1996 to almost 20 percent of the budgetary expenses, due to the two large investments that will be completed this year (surface waterworks and the sewage treatment plant).

The low level of investments is explained by the shortage of funds; there is really no funding (or credit) so there are no investments, either. Investments are stimulated by central subsidy programs. In certain cases the central funding is the trigger that launches an investment project.

Regarding the source of investments, in Szolnok the share of the state subsidies range between 20 and 60 percent, which provides substantial subsidies in the case of large investment projects of billions of HUF.

Credit could be an important funding source for investments. According to local opinions, however, the credit supply is not really advantageous for local governments' resources are tied. Short term credits prevail, whereas in the case of a large investment the chances of the local government could be improved by being able to spread expenditures over a longer period of time.

One positive example is the HUF 380 million EIB credit line, the servicing of which was successfully extended by the Szolnok budget until 2009. Such credit is not available from Hungarian commercial banks. Upon acceptance of the feasibility study, the investment project is expected to keep its planned resource structure in the course of the implementation. If it is not met in the course of the implementation, the investment will gradually start to be funded from credits which, in turn, gradually put up the costs of the development project. One example for this is the investment in Szántó boulevard where the share of credits grew to 50 percent.

The city has no investment strategy although some elements may be discerned from certain partial concepts; some requirements appear on some levels in an unstructured form, but there is no real ranking or planning in this area. The investments of the past six years may only retrospectively be called conceptual. It was a period of water projects which, however, only developed in the meantime, owing to the success of winning a targeted subsidy tender.

With respect to the investments of the period under review there are two extremes in the investment volumes. On one hand, out of the 21 projects of the period, there were four

projects with a total cost of over HUF 1 billion each; three projects worth hundreds of millions; with the rest worth tens of millions each. The funding structure of these large investments prove what has been said about the beneficial role of the subsidy policy applied by the central authorities, for most of them were implemented with large scale central subsidies (in some cases over 50 percent). It was only the subsidies that enabled them to be launched in the first place.

At the same time the local government's own funding also played an important role in these large investment projects in Szolnok, for the housing management and asset management projects were implemented exclusively with own funds. (Supposedly because real estate revenues were required to be re-invested in housing.)

On the other hand, the large investment projects also have a strong influence on the priority ranking of improvements. 64 percent of all investments were accordingly accounted for by the water/sewerage investments. The next development area is the housing sector (with a mere 16 percent), asset management (10 percent), road and bridge development (6 percent), and the 3 percent of the education related investments is only just worth mentioning. The shares of the rest of the projects, such as city embellishment, environment protection, medical instruments, and the improvement of the riverbed of the river Zagyva, were negligible.

It is seen as a step towards strategic thinking that the apparatus and the representative body are beginning to slowly accept concepts such as the:

- Re-investment of capital income in improvements.
- The use of statement of assets and capital costs in financial management.
- The launching of so called "business investments".

The downtown arrangement plan is seen as a kind of a business investment on the part of the local government, which is suitable for offering areas for businesses where blocks of buildings, not functions, have been strictly defined as conditions for construction. In the sale of the sites, however, the price of the land was defined by the local government in the amount of the public utility investments, i.e., the businesses invest in public utilities right at the beginning. (This system was already launched in Szolnok, but due to suspicion of abuse in connection with the first sales it was regrettably stopped.)

Upon the acceptance of the master plan, the seven or eight valuable industrial sites that have been designated as land to be sold, can also be a potential source of revenue.

At the same time the concept of transferring municipal development from the local governmental investment sector to businesses and opening up the area to enterprises has

been raised.

**The process of decision making on investments in Szolnok is as follows:**

When discussing the requirement of an investment, some of the city supply documents of Szolnok or the municipal development concept are used as a basis, and are compared with the relevant professional and sectoral guidelines, regulated by sectoral decrees.

Political attitudes are also strongly present, and from all of these factors a problem package is formed.

This is followed by a kind of budgetary planning to meet the specified professional indicators. This is also accompanied by an investor attitude of “what can funds be found for these days”. Only now can the planning of the investment begin; technical plans are drawn up, lobbying activities are launched and then a decision is made on the investment. If all goes well, a feasibility study and construction plans are prepared and then the local government puts the implementation out to a public procurement tender.

Although a feasibility study is an up-to-date pre-requisite for the launching of an investment, it is not always entirely accurate. According to an example of a road project in Szolnok, the available funding for an investment may be over-estimated and its expected expenses under-estimated in order to get the plan accepted by the representative body. In retrospect, the shortcomings of the preparations are evident, and the investment has so far cost tens of millions of HUF (the construction of a 600 meter section of a connecting road has cost HUF 440 million).

In Szolnok it sometimes happens that the decision on an investment is made without taking the budgetary reality into account.

An example of such an investment, implemented for reasons of political prestige, is the case of the covered swimming pool, which by the time of completion cost tens of millions of HUF. According to a bluntly put opinion within the apparatus, nobody even needs it, so an institution of inappropriate quality standards has been implemented at very high cost. Another type of prestige investment is that of the development of education. All schools would like to have Internet facilities (or to have them improved) and if they can, they enter tenders. But the costs of the Internet use have become a financial problem in Szolnok; amounting to tens of millions of HUF, they have begun to drain the municipal budget, a result which no one had originally expected.

The planning of an investment and its coordination can be essentially deployed to the

technical content or to the financial area. In Szolnok priority is definitely attached to the technical area, in the charge of the chief architect's office or the city management department. However, this leads to the division of the monitoring of the concrete process, and one of the areas is either left out or left behind. Asset management is also similarly fragmented in the local practice, as a result of which the financial effects of the investments cannot be clearly seen.

### **One example of an investment decision in Szolnok:**

The requirement for an investment to sufficiently improve the water quality was seriously raised in 1994. The technological improvement process started in the eighties made the need for continuation evident, but the technologically prescribed change would have required HUF 1.5 billion (of the then total budget of HUF 4-5 billion).

Since it was a substantial investment, it was started after careful preparation. In 1994 the city submitted an application for a targeted subsidy, which would have covered 30-40 percent of the total cost, according to the terms of the tender. The negotiations were started to secure the remaining 60 percent. The county water company had just been broken down into smaller local limited liability companies and a larger one that supplied Szolnok and four small communities. The incurring investment costs were planned to be covered from the revenues of the newly set up Szolnok water/sewerage company which were created by selling own assets, depreciation revenues and real estate sales. The question then was what degree of water tariff increase the communities would tolerate. So the water company and the municipalities sat down to negotiate on how to resolve the necessary technological requirements (ozone treatment, active carbon filtering) to substantially improve the water quality.

The major problem with the drinking water, the high chlorine content, was a result of the obsolete technology. It was a pre-condition for the winning of the targeted subsidy that the public utility be owned by the bidder and the local government be the investor. That is how the Water and Sewerage Co (Víz-csatorna Rt.) was established for the definite period until December 31, 1995. By 1996 the concession Company was set up, and the tender invitation was announced for the management and development of the water utilities.

The organizers of the tender invitation were said to have been afraid of the tender, for it had been considered a "delicate" area. Finally, the former county water company won the tender, for their bid had been found the best.

As part of the preparations the municipality commissioned an auditor expert firm known via a local entrepreneurial club "Hozam Klub" to prepare, implement and organize the tender

negotiation. The company was also in charge of the acquisition of the professional opinions, the presentation of the plans, organization of discussions, and obtaining the pre-qualifications. Following the pre-qualification a total of 4 companies remained running out of the original seven. The material so prepared was evaluated by the city development committee and submitted for decision making by the representative body, together with the summarized opinion.

The decision was based on technical considerations, which would provide the best both with respect to price and the management and quality of the whole public utility property. This was proven by the winning bidder, which was the best in terms of its concept—according to the opinion of the evaluators—and had the capacity to manage it expertly in the long run.

The decision shook the rejected foreign bidders, and some charges were raised. The first was that the decision had been taken by the local government in advance. The other was that the background of the winner was unfounded, since a HUF 10 million equity does not provide an appropriate guarantee for the management of the assets (HUF 4 billion) or for their development (HUF 1.5 billion).

The decision has, however, proven to have been a sound one. Both the local government and the municipality are content with the experience to date. The planned cost budgets have been adhered to, and additional funds could even be involved through KKA (Central Environmental Fund) to cover unplanned, additional technical investments.

The investment is permanently controlled on the basis of a relatively fixed algorithm, since the main contractor's agreement defines the schedule of the technical implementation in detail, along with the financial schedule and the schedule of the technical controlling activity. The financial department pays in a planned manner, on the basis of the technical implementation. The State Audit Office and the Tax and Financial Control Office carry out annual inspections and the funds are transferred via OTP in accordance with the performance, as befits the regulations on targeted subsidies.

The company will be paying a concession fee for the utilization of the works, which will be reinvested into the development during the investment. After the launching of the productive operation, 70 percent will be used for renovation, and 30 percent for other water investments to be implemented by the local government (this latter percentage will be renegotiated from time to time). The investment is scheduled to be completed in the summer of 1998. So far, the results are very good and it seems to be drawing towards completion to everyone's satisfaction. A number of organizations and persons are even claiming political merits in the project.



On the whole, it has been a process from which a number of lessons may be drawn for the city of Szolnok, for on the one hand it provides a basis for classification as there are some grave problems in a city, but they can be resolved through a well planned, sufficiently analyzed approach.

### **Summary**

In Szolnok, as in most Hungarian local governments, the investment level is low.

The city has no planned investment strategy.

A first step towards strategic planning of investments is the innovative financing tools introduced recently:

- Channeling capital revenues back to investments
- Using a capital budget
- Launching business investments

In local practice, in the management of investments engineering is the priority area, often to the detriment of economic and financial considerations.

Asset management in Szolnok is fragmented which makes investment management difficult.

Experience shows that both good and bad investments create typologies for problem solutions.

### **ASSET MANAGEMENT**

Substantial loss of value has been found recently in the assets of almost all local governments. The probable causes of the loss of equity include the fact that the substantial capital initially given to local governments was often sold quickly and without due care; some of the assets were sold out of necessity to cover operation costs in the first place and only a small portion of sales revenues were spent on investments.

In Szolnok—according to local opinions – billions worth of assets were sold at estimated value. Today a total of HUF 1 billion of equity has remained that may be mobilized if necessary, out of the total of HUF 10.5 billion registered assets. Each year some HUF 100 million of revenue from asset sales was spent on operations. In the 1990-1994 government term the loss making asset elements were ruthlessly divested. Forced sales also took place

because of the shortage of funds, primarily involving securities.

The evaluation of the equity, according to the local leaders, changed almost daily, in the previous term. This resulted partly from the fact that local governmental leaders had to face a set of duties that had been entirely missing from all of the preceding practices.

Previously the local government was fully restricted in its service provision responsibilities by centrally mandated given price and tariff items, even with respect to its equity related decisions. While previously they used to “hand over” a piece of agricultural land for cultivation, now they have to sell it at market prices.

And the problem of the change of roles arising from the new situation emerged not only on the part of the local governmental participants but also on the part of the other side. The tenants of local government owned premises found it problematic to establish a market based relationship with the local government when the local government wanted to re-negotiate the rents. The tenants had entered into contracts back in the days for long term (perpetual) lease with set rental fees and they intended to keep these while the municipality wanted market rents. But they have come to accept an annual adjustment of the rents (with the inflation rate).

The local practice of asset utilization, however, raises the conflicts inherent in the central regulations. For example, the housing privatization act gives the owner the power to dispose of his or her property, but even if an apartment building is owned by the local government, if it is part of the national property it can only be sold at defined prices. This results in substantial loss of equity for local governments.

A similar phenomenon is that the law creates an illusion that the ban on the sales of certain asset elements is an impermeable restriction—in fact this prohibition can be circumvented. Asset elements may be re-classified and local decrees on assets may specify local principles and opportunities. Accordingly at present only the landfill and the mortuary are not available for sale. The public parks in the master plan may later be built in by re-classifying their status. The assets of limited marketability and the business assets are mixed up in the Szolnok property registry since the local government has lifted the restriction.

The practice of local governmental asset valuation enables only partial overview of the property. Since 1994 there has been a regulation calling for the preparation of a so called asset cadastre. It is intended to register assets according to the movements of value, and to have a history for each asset element. It specifies the access, value, and other characteristics of assets.

In fact, however, the necessary market value data are not available, so the system can hold only assets specified by natural features. The statement of assets is the accounting

registration; it takes assets into account at value, as part of the annual report and financial statement. It also contains data of changes in value each year.

The key elements of the asset statement in Szolnok include:

— Tangible assets (land/building/construction in progress)	HUF 5-6 billion invested
— Financial assets (participations, compensation vouchers etc.)	Negligible
— Receivables	HUF 3-4 billion
— Cash	HUF 3-4 billion

The common ground of the two systems is the registration of the yearly change in asset value. The registration of property is complicated and in some cases prevented by the fact that some of the information, for example, the network and penetration of public, used to be undisclosed due to the former state ownership and there are no updated data as of yet.

It is a substantial problem that the assets are not sufficiently differentiated, for instance what assets are required for professional service provision, what is required for the operation of the municipality, the housing problem, the possibility of the management of non-residential real estates (business premises or worthless cellars, for example).

The situation has changed also in terms of what is necessary for the operation of the local government. Consequently, property related decrees have become fragmented, and ad-hoc, unprepared decisions have been made concerning the utilization of assets. A comprehensive picture seems now to be evolving. "There are fewer assets, we must concentrate" is the local opinion.

It is estimated that the composition of the assets currently is as follows:

— Housing property	HUF 2-2.5 billion
— Water utilities	HUF 4 billion
— District heating	HUF 0.5-1 billion
— Institutions	HUF 2-2.5 billion
— Suitable for mobilization	HUF 1 billion

To avoid previously often encountered ad hoc decisions it became rather urgent to create an up-to-date property decree in Szolnok in 1998. According to the decree the revenues collected from asset sales will be used for the creation of a specific reserve must

be used for investments. At the same time—according to locals—the decree is a step backward in many respects.

For instance, the department in charge of mobilizable assets can sell assets up to HUF 1 million (the limit used to be HUF 10 million). Over the limit (which includes most sales), all sales come under the jurisdiction of the asset management committee of the City Council, which will transfer the performance of the day-to-day duties of the area to a political plane.

On the whole, it is found that the local property management function lacks a concept, is fragmented, and is one of the least sound points of the local financial management system.

The registration of the assets was assigned to various departments within the office according to marketability. The assets are usually operated by the given local governmental institution, or the local government owned or contracted business entity. The office's sections are subordinated to the various departments of the organization structure, with indirect professional relations. Appropriate sections of the office do not even know the real value of the assets they are managing, and they do not even venture an estimate.

The maintenance of the assets is nobody's responsibility. The institutions do not have the money, the asset registry section is not in charge of it for it is not their job. Sales are effected on an ad hoc basis in the maze of the official apparatus, without the required commercial techniques or strategy.

The economic department, which plays a dominant role in the formulation of the economic strategy and in budgeting and is in charge of the local government's financial/accounting system, has been excluded from the sphere of disposal, registration and decision making with respect to the property, probably for personal conflicts.

There is no asset management strategy and the existing part-concepts do not meet. The decisions—made by politicians and in cases professionally questionable—and the level of execution are often in conflict.

There are no appropriately trained experts to exercise comprehensive control over the area. A sound, careful handling of these responsibilities often falls victim to personal tensions, resentments and rivalry.

## — **Summary**

- C Szolnok has lost much of its assets in recent years.
- C Evaluation of assets has changed several times.
- C The local assets evaluation practice was inadequate as data necessary for an assets record were missing.
- C Assets are not differentiated.
- C In Szolnok a new assets decree was created in 1998 to solve problems.
- C On the whole, in Szolnok asset management is organizationally fragmented and lacks a concept.

## C **CONCLUSIONS AND RECOMMENDATIONS**

Generally, findings of the research in Szolnok show that the city's financial leadership is innovative and looks out for new forms and solutions.

Some aspects of the innovations that bear importance in our research have been described earlier in the paper.

Obligations and difficulties that municipal officials have to face as well as some of the adequate, modern and efficient, workable solutions they have found have been discussed in details.

As a conclusion of our study, it is suggested that new and detailed analysis be carried out to examine further steps in the development of municipal finance. In Szolnok the following areas are recommended for work:

- Review the scope of municipal services.
- Develop a conscious taxation policy/strategy.
- Further renewal of the institutional system of service provision.
- Measurement of service quality and performance.
- Create a consistent investment strategy.
- Create an asset management strategy.

**ATTACHMENT**